(1) Network Elements (Paragraphs 83-85)

¶ 83 The Commission requests comment on its interpretation of "network element." Technical feasibility should be the driving consideration in the interpretation of "network element." To the extent that any facility or equipment used in the provision of telecommunications service can be feasibly and discretely provided, that facility or equipment should be considered a network element. Maximum technical flexibility in determining what is a network element is essential to reducing the LEC's (whether incumbent or facilities-based new carrier) bottleneck control over the marketplace. Competition will be furthered if telecommunications providers have the ability to configure their networks and services in as many ways as sound engineering permits. This flexibility will allow the marketplace to meaningfully vote on the preferred network configuration.

¶ 85 The Commission also requests comment on the relationship between Sec. 251(c)(3) and Sec. 251(c)(4). Secs. 251(c)(3) and 251(c)(4) create separate and distinct obligations for incumbent LECs. Pricing under the incumbent LEC's Sec. 251(c)(3) obligation is clearly required to be cost-based pursuant to Sec. 252(d)(1). The incumbent LEC's Sec. 251(c)(4) duty is not directly or necessarily constrained by cost-based considerations, but rather, by the retail price of the service. Sec. 252(d)(3). The statutory scheme clearly gives requesting carriers the option to obtain services from the incumbent LEC pursuant to either Sec. 251(c)(3) or 251(c)(4), or both. Even if the entire universe of network elements is unbundled, priced according to the appropriate cost basis, and then rebundled, an amount of gaming will occur due to the differentials in the two cost

structures (unbundled and wholesale). Furthermore, this gaming will continue until there is an equalization of the contribution recovered on an unbundled basis or a wholesale basis. It is too early to determine the significance of this issue. In the meantime, the Commission must guard against unreasonable and anticompetitive side-effects of this statutorily-sanctioned pricing differential.

(2) Access to Network Elements (Paragraphs 86-91)

¶ 86 OCC concurs with the Commission's interpretation of Sec. 251(c)(3) regarding the meaning of "access on an unbundled basis."

¶ 87 OCC concurs with the Commission's tentative conclusion respecting the burden of incumbent LECs to prove infeasibility of providing access to particular network elements.

(3) Specific Unbundling Proposals (Paragraphs 92-116)

(a) Local Loops (Paragraphs 94-97)

(b) Local Switching Capability (Paragraphs 98-103)

¶ 101 The Commission seeks comment on whether its definition of "port" is consistent with the requirements of Sec. 251(c)(3) OCC believes that the technical feasibility of providing a discrete functionality should be the guiding consideration with respect to the proper definition of network elements and functionalities. Once again, the burden must be on the incumbent LEC to demonstrate technical infeasibility.

(c) Local Transport and Special Access (Paragraphs 104-106)

(d) Databases and Signaling Systems (Paragraphs 107-116)

d. Pricing of Interconnection, Collocation, and Unbundled Network Elements (Paragraphs 117-157)

(1) Commission's Authority to Set Pricing Principles (Paragraphs 117-120)

¶ 117 In this paragraph, the Commission tentatively concludes that the Act gives it the authority to adopt pricing rules to ensure that rates for interconnection, unbundled network elements, and collocation are just, reasonable, and nondiscriminatory. The Commission also tentatively concludes that it has the authority to define "wholesale rates" and "reciprocal compensation arrangements." OCC agrees that such rules and definitions are within the Commission's authority. It should be clear, however, that the authority to issue such rules does *not* give the Commission the authority to actually *set* the rates in question. That is a matter reserved for carriers to attempt to resolve, and for states to arbitrate and assess for reasonableness. Sec. 252(a), (b) and (e).[6] *See* NPRM ¶ 118.

¶ 119 The Commission seeks comment on whether national pricing principles would be likely to improve opportunities for local competition by reducing or eliminating inconsistent state regulatory requirements. It is entirely possible that local competition would be enhanced by an entirely uniform national pricing structure. However, OCC

[6] This Commission becomes involved in the process when a state fails to act. Sec. 252(e)(5).

submits that it is more likely that some variation in local arrangements will provide greater opportunities for local competition by allowing the states to experiment with different methods adapted to the unique environment of each state. A homogenous approach would be more likely to reduce things to a common denominator that may not necessarily be optimum. Uniformity in pricing is far less important than uniformity in technical interconnection standards, as discussed previously We would note that this Commission lacks the power to mandate "consistent rates," even if consistent rates would enhance competition. Sec. 252(d)(1) says that the *states* are to determine just and reasonable rates.

(2) Statutory Language (Paragraphs 121-122)

¶ 121 The Commission seeks comment on the "proper interpretation" of Secs. 251(c)(2)(D), 251(c)(3), 251(c)(6), and 252(d)(1) The first three provisions simply require rates for interconnection, network elements and collocation that are just, reasonable, and nondiscriminatory. Rates for interconnection and network elements are to be judged based on the requirements of Sec. 252(d)(1). (See discussion at ¶ 122, *infra*, for collocation rates.) Under Sec. 252(d)(1), the determination by a State commission of just and reasonable rates for interconnection and network elements

> (A) shall be --
> (i) based on the cost ...of providing the interconnection or network element ..., and
> (ii) nondiscriminatory, and
> (B) may include a reasonable profit.

This obviously gives state commissions considerable latitude in judging network element and interconnection rates. Any rules this Commission issues should respect that latitude.

One key issue is the interpretation of the phrase "based on the cost of providing" the service. Some stakeholders have argued that interconnection and network elements should be priced *at* incremental cost. However, the fact the statute says that prices for network elements are to be "based on" costs implies that prices should not generally be "at" incremental cost, and should include some contribution to joint and common costs. On the other hand, the fact that profit for the provider is only suggested, not mandated, also implies some limitation on the amount of contribution that can be exacted from these network elements, as does the requirement that the profit be reasonable. See discussion at ¶¶ 128-131, *infra*.

¶ 122 The Commission seeks comment on whether the same pricing rules that apply to interconnection and network elements should apply to collocation, given the lack of a specific statutory directive (such as that provided by Sec. 252(d)(1) for interconnection and network elements) for collocation. As discussed below in ¶¶ 128-131, OCC proposes only very general pricing rules for interconnection and network elements. These rules place outer bounds on what is "just and reasonable" (the standard that also applies to collocation), and could, therefore be applied to collocation without violating the statutory scheme. As with interconnection and network elements, it is up to the states to set specific just and reasonable prices for collocation within these general constraints.

(3) Rate Levels (Paragraphs 123-148)

¶ 123 The Commission tentatively concludes that the Act "precludes states from setting rates by use of traditional cost-of-service regulation, with its detailed examination

of historical carrier costs and rate bases." OCC tentatively agrees, with these qualifications: Sec. 252(d)(1)(A)(i) says that the rates shall be based on the cost "determined without reference to a rate-of-return or other rate-based proceeding." This implies that what is forbidden is *not* a "detailed examination of historical carrier costs," as the Commission puts it, but a rate-base, rate-of-return *proceeding* involving examination of all of the carrier's costs and rates. Thus the embedded costs of interconnection and network elements may indeed be examined in the course of setting rates for those services.

¶ 144 The Commission should not issue rules that forbid the examination of embedded costs. Those costs should be used as a test in judging the rates, as discussed below.

(a) LRIC-Based Pricing Methodology (Paragraphs 126-133)

¶ 126 The Commission requests that commenters provide "precise definitions" of the following terms: LRIC, TSLRIC, forward-looking costs, joint costs, common costs, shared costs, stand-alone costs, embedded costs, fully distributed costs, overheads, contribution, and residual costs. OCC respectfully declines this invitation at this time; we expect to provide replies to the definitions proposed by others. However, we would note that, even in the absence of precise definition, the concepts that appear most relevant here are TSLRIC, joint costs, common costs, stand-alone costs, embedded costs, and contribution, as detailed below.

¶¶ 128-131 These paragraphs are the key portion of this section of the NPRM. The Commission requests comment on the costing methodologies currently used by a

number of states (¶128); on a variety of LRIC-based approaches (¶ 129); on problems in allocating common costs where priced are above LRIC (¶ 130); and on the meaning of "reasonable profit" in Sec. 252(d)(1)(B). ¶ 132. OCC will present its comments on these questions as a unified approach.

To begin with, TSLRIC should be the price floor. It is well understood that if a service is priced below TSLRIC, that service is being subsidized. We think it unlikely that any carrier would seek to supply a network element or interconnection to a rival firm at a price below TSLRIC. However, as noted by the Commission (¶ 127), some states have *ordered* prices to be at TSLRIC. OCC believes this to be inconsistent with the "based on cost" language of Sec. 252(d)(1)(A)(i). If Congress had intended prices for interconnection and network elements to be "at" costs, that is how the statute would read. Further, as the Commission notes (¶ 129), "[t]here may be a problem with basing rates on LRIC alone if there are significant joint and common costs among network elements...."

Thus services should be priced above TSLRIC, and will thus make some contribution to the common and overhead costs of the supplying firm. The question is, how much contribution?

OCC very strongly urges this Commission to require that rates for interconnection and network elements provide a reasonable contribution above incremental costs. This is the position OCC presented to the Public Utilities Commission of Ohio (PUCO) in comments in the PUCO's generic local competition docket, Case No. 95-845-TP-COI, *In the Matter of the Commission Investigation Relative to the Establishment of Local*

Exchange Competition and Other Competitive Issues. Another way of putting this is that we agree with the view of the Local Competition Work Group of the NARUC Staff Subcommittee on Communications that network component prices should recover at least TSLRIC and a markup over TSLRIC to reflect a reasonable allocation of joint and common costs.

Just as, in economic theory, pricing above incremental cost ensures that the service is not being subsidized, economic theory also addresses the question of when a service is *providing* a subsidy. The classical answer is that a service is not providing a subsidy so long as it is priced below the cost of providing that service on a stand-alone basis. We agree with the Commission (¶ 130) that "regardless of the method of allocating common costs, [it] should limit rates to levels that do not exceed stand-alone costs."

Yet using stand-alone costs as a ceiling for interconnection and network element rates would not be just and reasonable. Nor would it comport with the pro-competitive thrust of the 1996 Act. Thus the "reasonable contribution" to common costs must be somewhere below the contribution provided by a rate at stand-alone costs.[7]

OCC submits that an absolute ceiling for these rates ought to be the carrier's embedded costs. ¶ 144. To allow recovery of more than a carrier's embedded cost for these services, so crucial to the encouragement of competition, would clearly be counterproductive.

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[7] Pricing based on the Efficient Component Pricing Rule (ECPR) would also provide an excessive contribution, in addition to not being based on cost, as the Commission notes. ¶ 147.

Thus we have a floor (TSLRIC) and a ceiling (embedded cost). Should this Commission make an attempt to set rates with greater specificity?

The Commission states, following the NARUC staff recommendation, "[W]e could require prices to be based on the LRIC of the applicable service or unbundled element plus a reasonable allocation of forward-looking joint and common costs." ¶ 129. Admittedly, this formulation of the amount above incremental cost is theoretically different from the more general notion of a reasonable contribution above LRSIC. Yet unless this Commission wishes to impose a strict nationwide value of what "reasonable contribution" or "reasonable allocation" might be, it seems clear that this is a matter best left to the states.

Nothing in the Act gives any indication that Congress intended there to be uniform nationwide interconnection and network element rates. Basing the floor of the rate on carrier's incremental costs also means that the rate will vary from carrier to carrier. And the fact that Sec. 252(d)(1)(B) allows that the rates "*may* include a reasonable profit" (emphasis added) indicates that the inclusion of a reasonable profit is at the discretion of the state commission, which must make the determination of the just and reasonable rates in the first place. Sec. 252(d)(1).[8]

This Commission cannot deal with the disparate nature of local costs and the discretion accorded the state commissions by adopting an inflexible rule for judging

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[8] It is an interesting condition that the Act forbids the rates from being based on a rate-of-return proceeding (Sec. 252(d)(1)(A)(i)), but allows the inclusion of a reasonable profit. Sec. 252(d)(1)(B).

whether interconnection and network element rates meet the statutory test. OCC submits that the Commission should adopt principles defining a floor and a ceiling, and thereafter allow the states to use the flexibility that the Act gives them, with the Commission providing oversight.

¶ 132. The Commission then seeks comment on whether it should adopt a transitional pricing mechanism, for example, requiring rates to be set at short-run marginal cost. Although such an approach "might give incumbent LECs an incentive to reach a rapid agreement," it would do so at the cost of allowing the interconnection rates and network element charges to be subsidized (in the classic sense) by the LEC's other rates and hence the LEC's end user customers. Further, this proposal violates the Act, by disallowing any opportunity for a state to "include a reasonable profit" in these rates. Sec. 252(d)(1)(B). Under the framework proposed by OCC, no transitional mechanism is necessary.

¶ 133 The Commission asks whether interconnection and unbundled rate elements should be set on a geographically- and class-of-service-averaged basis for each incumbent LEC, or whether some form of disaggregation would be desirable. Given the fact that the Act is silent on the subject of geographic averaging in this context (as opposed to the Act's mandate of averaged rates for interexchange services -- Sec. 254(g)), OCC submits that this is another issue best left to the states. Further, the Commission asks whether class-of-service disaggregation is appropriate. OCC submits that, given that the Act permits states to impose intercategory restrictions on resale (Sec.

251(c)(4)(B)), it would not be inconsistent with the Act for a state to establish disaggregated pricing for network elements that parallels the intercategory restriction. Again, given the broad discretion afforded the states in OCC's proposal, disaggregation is a matter for the states to decide, and the most this Commission should do is to acknowledge in its rules that the states have this latitude in their rate-setting.[9]

(b) Proxy-Based Outer Bounds for Reasonable Rates (Paragraphs 134-143)

¶¶ 134-135 The Commission here discusses rate ceilings as "outer bounds" for reasonable rates. We note that rate floors are just as important. NPRM ¶ 143. As discussed above, OCC believes that the Commission's principal responsibility should be establishing principles for rate ceilings and rate floors. We do not believe that this Commission is able or authorized to establish mechanisms in such detail as to ensure that the three principles set out in ¶ 135 are met

¶¶ 136-141 Here the Commission discusses a number of alternatives for establishing proxies for an appropriate cost ceiling. One fundamental question is whether the use of existing costs or existing rates for the proxy is preferable. OCC submits that the use of existing rates (no matter how manipulated or massaged -- *see* NPRM ¶ 139) may be

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[9] The Commission also seeks comment on whether some cost index or price cap system would be appropriate to ensure that rates reflect expected changes in unit costs over time. This is also a matter for the states. If the Commission takes any action in this area, it should be to ensure that rates decline consistent with the expected continued decline in telecommunications costs.

appropriate for a ceiling. However, a proxy using generic *embedded cost* data would be superior, as discussed above.[10]

In any event, a proxy-based ceiling (whether national in scope or disaggregated by population density -- *see* NPRM ¶ 137) should not and cannot be used as a definitive determinant of whether an incumbent carrier's interconnection or network element rates are just and reasonable. Rather, an FCC-established proxy should be used by the states to gauge the reasonableness of state-determined rates. There may well be circumstances where that proxy may be too high, and a more realistic ceiling should be used.

(c) Other Issues (Paragraphs 144-148)

¶ 144 We discussed above the relevance of embedded costs (used as a ceiling) to the determination of cost-based interconnection and network element rates. Here, the Commission asks, "Should we establish LRIC as a long-run standard, but permit some interim recognition of embedded costs in the short run?" For both the long and short run, rates must *exceed* LRIC. As the Commission states, "In economic terms, prices in competitive markets *are based on* a firm's forward looking costs rather than historic (sunk) costs." Although in competitive markets prices may be based on the firm's forward looking costs, prices which do not exceed those costs are not sustainable: The firm must recover some contribution toward joint, common, and overhead costs from all services. This is especially true in the local exchange market, given that most ILECs are likely to

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[10] We doubt that either the Benchmark Costing Model or the Hatfield study would, in fact, be appropriate for determining proxy costs for interconnection and network elements other than loop costs (NPRM ¶ 137), given the thrust of those studies.

have some customers in some areas that have no competitive alternatives. Requiring services sold to the ILECs' competitors to be priced at incremental costs will force the ILECs to seek to squeeze that contribution from the remaining monopoly customers.

(4) Rate Structure (Paragraphs 149-154)

¶ 152 We agree with the Commission that it should require states to provide for recovery of dedicated facility costs through a flat rate option. We also agree with the Washington Utilities and Transportation Commission finding, cited in this paragraph, that measured use interconnection rates are not cost-based and could harm local consumers. We say this on behalf of residential consumers, who overwhelmingly prefer a flat-rated local calling structure. It cannot be forgotten that, for carriers as well as consumers, a usage-based system imposes metering and billing costs not present under a flat rate regime. Indeed, as the traffic-sensitive costs of the network continue to decline, the costs of measurement and billing represent a more and more significant cost factor.

¶ 153 The Commission seeks comment on whether, in the context of these bottleneck facilities offered by incumbent LECs to their competitors, any measures are necessary to prevent incumbent LECs from recovering more than the total cost of a shared facility from users of that facility. Here again, the superiority of a capacity-based or flat rate charge is apparent: Under a usage-sensitive scheme, it is entirely possible for an ILEC to recover more than the cost of the facility if usage grows sufficiently. No such danger is present under a capacity-based mechanism. (On the other hand, *underrecovery* is possible under either regime.)

The Commission also seeks comment on whether it should require or permit volume and term discounts for unbundled elements or services. Given the ubiquity of volume and term discounts throughout this industry (and indeed throughout the entire economy) it is difficult to justify a ban on such discounts. However, the Commission should not impose a requirement for volume and term discounts. OCC submits that the Commission should require that volume and term discounts which are offered be available on a nondiscriminatory basis, but should leave to the states the judgment of whether specific discounts are reasonable.

(5) Discrimination (Paragraphs 155-156)

¶¶ 155-156 The Commission seeks comment on the difference between the requirements of Sec. 251 and 252 that interconnection and network element rates be "nondiscriminatory" and the pre-1996 Act requirement of Sec. 202(a) forbidding "unjust or unreasonable" discrimination. Clearly, the 1996 Act's requirements are more stringent; some discrimination that might not have been deemed "unjust or unreasonable" is nonetheless discrimination, and would be forbidden under the 1996 Act.

(6) Relationship to Existing State Regulation and Agreements (Paragraph 157)

¶ 157 The Commission seeks comment on the meaning of the specific terms of Sec. 251(d)(3) barring the Commission from precluding the enforcement of certain state regulations.[11] OCC submits that it would be a strain to find difference in the meaning of

[11] We note that, despite the Commission's characterization of such regulations as "existing" (implying that they precede the 1996 Act or the regulations issued in this

Sec. 251(d)(3)(B) (barring the Commission from precluding enforcement of a state regulation that "is consistent with ... this section") and Sec. 251(d)(3)(C) (barring the Commission from precluding enforcement of a state regulation that "does not substantially prevent implementation of this section"). The language of (C) establishes a much clearer standard.

Further, the Commission asks parties to identify what types of state policies would not be consistent with the Act. OCC submits that this is not an issue for which rules are appropriate. The Commission should address the principles of Sec. 251(d)(3) on a case-by-case basis when called upon to preempt a state commission under Sec. 252(e)(5).

e. Interexchange Services, Commercial Mobile Radio Services, and Non-Competing Neighbor LECs (Paragraphs 158-169)

(1) Interexchange Services (Paragraphs 159-165)

¶¶ 159-165 OCC agrees with the Commission that

- Sec. 251(c)(2) only requires ILECs to offer interconnection for telephone exchange service and exchange access. ¶ 160.
- Interexchange access is neither exchange service nor exchange access. ¶¶ 160-161
- Thus the obligation to provide interconnection does not apply to interexchange traffic. ¶ 161.

We also believe that interconnection must be purchased to provide *both* exchange service and exchange access. ¶ 162. In this instance, if Congress had meant exchange access *or*

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docket), nothing in the wording of the statute indicates that it does not apply to State regulations promulgated subsequently.

exchange service, it would have said so. The problems recognized by the Commission in ¶ 162 from a disjunctive use of the "and" also argue that the conjunctive is more reasonable.

In ¶ 164, the Commission zeroes in on the problem arising from the conclusion in ¶ 163 that "any carrier" may purchase unbundled network elements to provide any "telecommunications service." That is, purchasing an unbundled loop would allow bypass of interexchange access charges without the carrier offering exchange service. Increasing competition for *local exchange service* is, in fact, the key purpose of the Act. Decreasing IXCs' costs is not a necessary part of that design. Thus we agree with the Commission's interpretation that a loop should not be able to be purchased in order to provide only interexchange access; the customer must also receive local exchange service through that loop.

Another way of looking at this issue is that a loop may be purchased to provide only interexchange access, but that the price will be the same as a loop purchased to provide both local exchange access and interexchange access. In that situation, the customer would require two loops. Indeed, OCC submits that nothing in the Act forbids a state commission from setting rates for the interexchange access loop ***higher*** than the loop for local service access. The differential contribution to be received by the ILEC as a result of the loss of toll access charges does not make the rate any less cost-based. Nor does the fact that the loop is used for different purposes make the difference in price discriminatory. To some extent, this is a parallel to the New York "pay or play" regime. *See* NPRM ¶ 145.

(2) Commercial Mobile Radio Services (Paragraphs 166-169)

¶ 169 The Commission identifies one consequence of CMRS carriers being within the purview of Sec. 251(c)(2), that being whether such a CMRS provider remains subject to Sec. 332(c). OCC would note another consequence: By bringing itself within the reach of the 1996 Act, the CMRS provider also definitively brings itself within the reach of Sec. 254(d) as a provider of universal service support funds

(3) Non-Competing Neighboring LECs (Paragraphs 170-171)

¶ 171 Here, despite recognizing that the specific language of Sec. 251(c)(2) would encompass interconnection arrangements between neighboring LECs, the Commission states that, "in context ... the requirements set forth therein could arguably be understood to apply only to *competing* carriers." (Emphasis in original.) First, the plain language of the statute is clear enough; resort to context is not necessary. Second, the "non-competitive" status of neighboring LECs is not likely to continue for long, given the Act's removal of barriers to entry. Sec. 253(a).

Thus the agreements between neighboring LECs *are* covered under Sec. 251(c)(2). Consequently, these agreements (fairly uniformly based on a bill and keep arrangement) must be made available to other carriers. Sec. 252(i).[12]

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[12] It is perhaps to avoid this possibility that Ameritech has attempted to terminate all of its bill and keep EAS arrangements. *See* ¶ 48, *infra*.

III.B.3. Resale Obligations of Incumbent LECs (Paragraphs 172-188)

a. Statutory Language (Paragraphs 172-173)
b. Resale Services and Conditions (Paragraphs 174-177)

¶ 174 OCC agrees that Sec. 251(c)(4) only applies to ILECs; only they are required (or allowed) to provide resale at a predetermined wholesale rate. We also agree that the burden on non-incumbent LECs is different. Sec 251(b)(1). However, we would note that nothing in the Act would prevent a state commission from requiring new carriers, *i.e.*, non-incumbent facilities-based LECs, to resell their services at a price *below* the wholesale rate mandated for ILECs. More importantly, we submit that nothing in the Act prevents a state from requiring non-incumbent LECs to resell their services at a wholesale rate.

¶ 175 Here the Commission asks, "Should the incumbent LEC have the burden of proving that a restriction it imposes [on resale] is reasonable and non-discriminatory?" The burden should not be on the ILEC in this specific area unless in all other areas the ILEC or the NEC is also required to bear such a burden to demonstrate reasonableness and non-discrimination. OCC recommends that the LEC only bear such a burden for claims of technical infeasibility of interconnection.

However, we do agree with the Commission that the range of permissible resale restrictions should be quite narrow. This position controls our view of the next area for comment: whether the resale obligation extends to an incumbent's discounted and promotional offerings. We would argue that discounted offerings should be subject to resale, but that the resale of those offerings should be subject to the same restrictions that

apply to the ILEC's retail customers. Temporary promotional offerings, on the other hand, should not be subject to resale; if the promotion endures beyond some limited period, however, the resale option must become available. Otherwise, the "temporary" promotion will become an anticompetitive option not subject to resale.

Finally, the Commission requests comment on whether a LEC can avoid the resale obligation by withdrawing the retail service offering. Clearly, the LEC that took such a course would be denying itself the retail revenues from the service. And we submit that if a LEC engaged in such anti-consumer behavior, the unbundled network offering requirement would send competitors scurrying to meet the now-unmet demand. In any event, we doubt whether a state commission would allow an ILEC to abandon a service for which there were no alternatives but for which there existed significant demand. Proper authority for dealing with such situations lies with the states.

¶ 176 The Commission suggests that Sec. 251(c)(4)(B)'s allowance of intercategory resale restrictions "suggests that Congress did not intend to allow [resale] of a service that ... is offered at subsidized prices to a specified category of subscribers...." Nothing in the Act states, or even suggests, that the only proper intercategory restrictions are for subsidized services. As argued by OCC in our reply comments in CC Docket No. 96-45 (at 2-3), residential service is *not* subsidized (is not being provided below incremental cost). We must acknowledge, however, that business (or non-residential) basic service typically provides a greater contribution above incremental cost than does residential basic service. (On the other hand, discretionary non-basic services also typically

provide a greater contribution than does basic) There are long-standing valid public policy reasons for this differential. *See, e.g.*, Phillips, *The Regulation of Public Utilities* (2nd ed., 1988) at 478. It would disserve the ILECs who have long followed this public policy directive (and their customers) to allow a competitor to buy the lower-priced (but unsubsidized) residential service and resell it to a business customer.

¶ 177 The Commission requests comment on whether requiring new entrants to cope with resale policies that are inconsistent from one state to another would disadvantage them competitively in a manner inconsistent with the 1996 Act. OCC submits that it might be a burden on new entrants to deal with differing resale restrictions from state to state. However, the power to adapt resale restrictions to local conditions is one of the many specific concessions to state authority made by the Act. A burden on resale which comports with the principles in the Act (Sec. 251(c)(4)(B)) is *per se* consistent with the Act, and therefore not subject to this Commission's authority.

c. Pricing of Wholesale Services (Paragraphs 178-188)

(1) Statutory Language (Paragraph 178)

¶ 178 We agree that the Act gives the Commission the power to issue rules governing the determination of wholesale prices However, as with the prices of interconnection and network elements, the actual price-setting authority rests with the states. *See* ¶ 117, *supra*.

(2) Discussion (Paragraphs 179-183)

¶ 180 The Commission seeks comment on whether it should determine that states are permitted under the Act to require ILECs to quantify the costs that Sec. 252(d)(3) requires be deducted from retail rates to arrive at the wholesale rate. Actually, such a calculation is required by the Act. Sec. 251(c)(4). Indeed, OCC respectfully suggests that the Commission lacks the authority under the Act to forbid the states from identifying these elements of the required calculation.

¶¶ 181-183 Here the Commission requests comment on the details of determining wholesale rates. OCC will reserve most of its comments for reply on this issue. However, we would note that the Act forecloses a position taken by some stakeholders in these debates, that wholesale rates should be priced at a services' incremental cost. There is no way to reconcile the Act's determination that wholesale rates should be retail rates less avoided costs with this incremental cost notion.

(3) Relationship to Other Pricing Standards (Paragraphs 184-188)

¶¶ 184-188 Here the Commission requests comment on possible conflicts between the wholesale rate pricing standard of Sec. 252(d)(3) and the network element pricing standard of Sec. 252(d)(1). The Commission focuses on the notion of an imputation rule, which "prevents anticompetitive price squeezes by incumbent LECs, which may set unbundled element prices too high in order to discourage new entrants from purchasing unbundled elements instead of purchasing and reselling the bundled service." OCC's comment on this issue is that the Act established these two separate

standards; if one standard proves to be more advantageous to the ILECs than to the new carriers, so be it. The Act neither requires nor suggests the imposition of an imputation test on the states.[13]

More importantly, we must challenge (or at least call attention to) the way that the Commission has framed its question to accede to the industry's fundamental error in costing local services. The "hypothetical" recited in NPRM ¶ 185 has the cost of basic residential local exchange service as $25, "including a $20 cost for the loop element and a $5 cost for the port element, and the retail rate for such service ... is $10." Not only is the retail rate in the example significantly under the actual average rate[14], but the total cost of the loop is presumed to be appropriately imposed on basic local exchange service, despite the fact that the loop is a joint cost shared among virtually all telecommunications services.

As argued by OCC in the CC 96-45 docket, the notion that residential basic service is subsidized is dependent on loading the costs of the local loop onto basic service. Given that error, the entire notion of an imputation rule for LEC retail services is essentially frivolous.

The Commission asks for comment on the "relative advantages and detriments" of a policy requiring "restructuring" of retail rates to eliminate subsidies, asking whether such

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[13] Equally, the Act does not forbid a state from imposing an imputation requirement on its own initiative.

[14] According to the comments filed in Docket No. 96-45, the average retail rate for residential service is between $16 and $20. *See* OCC Reply Comments at 10.

changes are mandated by Sec. 254(f). The subject has been debated in the 96-45 docket; as argued there, nothing in the Act mandates such "restructuring" or "rebalancing." In this context, however, the Commission cites to Illinois' restructuring of retail rates. We would note that Illinois appears to be the only state in the nation that has eliminated flat rate service for residential consumers. Clearly, the Illinois Commission has allowed economic theory to outdistance regulatory equity.

Finally, putting aside the question of whether residential service as a whole is actually priced above its cost, we must address the concept of a Commission preemption order requiring that rates for local service exceed the cost of providing that service. ¶ 188. Such an order would, first of all, require the Commission to make a determination of the proper allocation of joint and common costs to basic local service. Nothing in the Act suggests that such a calculation is within the Commission's purview. The other key question is whether the Commission would override any state-mandated geographic averaging of residential rates. Such action would be inconsistent with the Act's mandate of geographically averaged interexchange services

II.B.4 Duty to Provide Public Notice of Technical Changes (Paragraphs 189-194)

Addressed in Part 2 of OCC's Comments, to be filed May 20, 1996 per NPRM ¶ 290.

II.C. Obligations Imposed on "Local Exchange Carriers" by Section 251(b) (Paragraphs 195-263)

II.C.1. Resale (Paragraphs 196-197)

¶ 196 OCC cross-references our comments on this paragraph to our comments on paragraphs 45 and 172-177. Fairness calls for the same resale restrictions to be placed on all "local exchange carriers" whether they be incumbent LECs or other providers. OCC supports resale and recommends that only very limited restrictions be implemented. These same restrictions should be applied to non-incumbent carriers as well.

II.C.2 Number Portability (Paragraphs 198-201)

No comments are requested in the NPRM.

II.C.3. Dialing Parity *and* II.C.4. Access to Rights of Way (Paragraphs 202-225)

Addressed in Part 2 of OCC's Comments, to be filed May 20, 1996 per NPRM ¶ 290.

II.C.5. Reciprocal Compensation for Transport and Termination of Traffic (Paragraphs 226-244)

a. Statutory Language (Paragraph 226)

¶ 226 This section of the NPRM addresses reciprocal compensation for transport and termination of traffic. The Act addresses this issue with unequivocal language that places it squarely within the jurisdiction of the states. Sec. 252(d)(2). Indeed the sole reference to the FCC in Sec. 252(d)(2) is in subsection (B)(ii) where the Commission and any state commission are prohibited from engaging "in any rate regulation proceeding to establish with particularity the additional costs of transporting or terminating calls..." OCC's recommendation that the FCC suggest broad general principles for costing and

pricing methodologies is in synch with the intent and language of the Act. Additionally, definitive rules from the FCC may inhibit the ability and willingness of parties to negotiate and arrive at their own solutions to traffic compensation issues, at least on an interim basis.

b. State Activity (Paragraphs 227-229)

¶¶ 227-229 As stated above, any action by the FCC should not limit the ability of the states to continue to act in their own best interests. The states have functioned, quite satisfactorily, as regulatory laboratories and they should be allowed to continue as such. Sec. 251(b)(5).

c. Definition of Transport and Termination of Telecommunications (Paragraphs 230-231)

d. Rate Levels (Paragraphs 232-234)

¶ 232 This paragraph requests comment on whether the pricing policies for unbundling and interconnection are independent of one another or whether they should be considered together. OCC's recommendation for broad guiding federal pricing principles would make the resolution of this question moot. However, even though the services and functions made available through interconnection and unbundling are very different, the pricing principles (*i.e.*, LRSIC as a price floor) would apply to both.

¶ 234 This paragraph seeks comment on several rate level issues. It is in keeping with the Act for the FCC to establish a specific generic pricing methodology to guide the states in setting the charge for the transport and termination of traffic. Our recommendation for broad pricing principles applies here also. However, if generic rules